

## **A Profit Sharing Plan May Be Better Than A SEP Plan**

*A Profit Sharing Plan may be a better retirement plan solution for your client than a Simplified Employee Pension Plan (SEP Plan). For many years, business owners have taken the path of least resistance by establishing a SEP instead of a Profit Sharing Plan because it was simple and easy to understand, provided for the same deductible contribution as a Profit Sharing Plan without the administrative costs and reporting requirements associated with all qualified retirement plans. However, in the changing economic environment, your clients may no longer be able to meet their long range retirement goals with a SEP*

SEP Plans were originally established by the Revenue Act of 1978 as an alternative to the complex rules that ERISA imposed on all qualified retirement plans. A SEP is an individual account or annuity plan that has special rules regarding participation, discrimination, withdrawals, and an employer allocation formula but is a simplified means of providing substantial deductible retirement benefits with very low administrative cost. However, since EGTRRA (Economic Growth and Tax Relief Reconciliation Act of 2001) was passed, a SEP may no longer be the best retirement plan solution for your client. A Profit Sharing Plan may be better.

Like a Profit Sharing Plan, the contributions are flexible year to year and the maximum deductible contribution allowed in a SEP is 25% of participating payroll. However, unlike a Profit Sharing Plan which establishes a plan trust which holds all of the plan assets, all contributions to a SEP Plan are made directly to the participant's IRA. This means a business owner, age 56 with no employees and earning \$100,000, could set up a SEP-IRA, make a maximum tax-deductible contribution of \$25,000 and not have to worry about all of the other requirements associated with Profit Sharing Plans. However, because SEP Plans cannot allow for elective deferrals as a Profit Sharing Plan can, the business owner may be limiting the amount of money that can be put aside for retirement as well as the tax savings with a SEP Plan.

Here's why: There is a limit on the contribution that can be allocated to any individual in either plan, which is the lesser of \$49,000 or 100% of compensation, as indexed for 2010. Additionally, the maximum individual deferral amount, as indexed for 2010, is \$16,500 plus, a participant, who is age 50 or older, is eligible to make a catch-up contribution of \$5,500, as indexed for 2010, for a total additional contribution of \$22,000. So the same business owner could establish a solo Profit Sharing/401(k) Plan and increase his contribution amount to \$47,000 which is an increase of his deductible contribution by 90%. The additional good news here is that there are no reporting requirements associated with a one-participant or one participant and spouse plan until the plan assets total \$250,000 or more. Even then, only a 5500EZ is required to be filed.

Under another scenario, your client may have 1 or more employees, or part-time employees. The SEP rules require that once eligible, all employees who earn \$550 or more, as indexed for 2010, whether full-time, part-time or seasonal, must be included in the plan. Additionally, all contributions are generally made proportionate to salary and are immediately 100% vested. This means that if a SEP contribution is made on behalf of an employee today, and the same employee terminates service with the employer tomorrow, the employee takes that SEP contribution with them, because all contributions are deposited directly into the participant's IRA. Profit Sharing Plans allow for the exclusion of part-time employees if they work less than 1,000 hours for the year, individual allocations may be made based on age and salary (which will benefit the older employer who earns more than his employee(s)), and a 6-year graded vesting schedule may be used. A vesting schedule may also help to retain valuable employees. In the event an employee does terminate employment who is not 100% vested, the remaining non-vested or forfeited portion of his/her benefit may be reallocated to the rest of the plan participants, including the business owner.

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If the business owner has employees, it's even better to establish a Profit Sharing Plan/401(k), as illustrated below. By adding the deferrals and catch-up contributions to a new comparability Profit Sharing Plan contribution, the business owner increases his maximum tax-deductible contribution by 118%.

	Age	Salary	SEP Plan Contribution Allocations		Profit Sharing/401(k) Plan Contribution Allocations*	
<b>Owner</b>	<b>56</b>	<b>\$100,000</b>	<b>\$25,000</b>	<b>25%</b>	<b>\$54,500</b>	<b>55%</b>
Employee A	40	30,000	7,500	25%	1,500	5%
Employee B	35	27,000	6,750	25%	1,350	5%
Employee C	28	23,000	5,750	25%	1,150	5%
Employee D	23	19,000	4,750	25%	950	5%
<b>Total</b>			<b>\$49,750</b>		<b>\$59,450</b>	

\*assumes a new comparability allocation and safe harbor 401(k) formula. Figures assume maximum contributions and benefits, as indexed for 2010.

Another important benefit to establishing a Profit Sharing Plan is that the business owner may purchase life insurance on a tax-deductible basis by purchasing it through the Profit Sharing Plan Trust as long as the premiums are within the incidental benefit limits. Life insurance is not available in a SEP Plan because the contributions are made directly to an IRA. Benefits include the availability of plan loans which do not exist in SEP Plan, and if paid back in timely manner, is not taxable to the participant. Once money comes out of a SEP Plan, it is taxed as ordinary income, and if the participant is under age 59 1/2, may be subject to penalty taxes as well.

Of course, there are some instances where a SEP Plan may be the most appropriate plan for your client. If the business owner wants to make a smaller contribution and doesn't have employees, a SEP Plan can be a suitable low cost option. Additionally, if your client has no interest in plan loans and life insurance is not a consideration at this time, a SEP Plan may be the easiest plan to implement. However, if your client has real business planning needs and needs a way to fund for their retirement in an efficient manner, your client should consider implementing a Profit Sharing Plan.

For more information on Profit Sharing Plans or any of Guardian's qualified retirement plans, please call 1-800-871-7780, Option 3, Option 4.

GEAR # 2010-0317

Approved: 1/11/2010

Expiration: 12/31/2010

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